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T. Hughes Reply Affidavit – Attachment B

Nos. 99-3833 & 99-3908

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

SOUTHWESTERN BELL TELEPHONE COMPANY,

Plaintiff-Appellant,

v.

MISSOURI PUBLIC SERVICE COMMISSION, et al.

Defendants-Appellees.

Appeal from the United States District Court
for the Western District of Missouri

BRIEF FOR DEFENDANT-APPELLEE AT&T COMMUNICATIONS OF THE SOUTHWEST, INC.

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Dated: February 14, 2000

CORPORATE DISCLOSURE STATEMENT

Pursuant to Rule 26.1 of the Federal Rules of Appellate Procedure, Defendant - Appellee AT&T Communications of the Southwest, Inc. (AT&T), states the following:

AT&T is a communications company. Through one or more wholly-owned intermediate subsidiaries, AT&T is ultimately a wholly-owned subsidiary of AT&T Corp., which is a publicly-traded company. No publicly-traded company owns 10% or more of the stock of AT&T Corp. The following subsidiaries or affiliates of AT&T Corp. have outstanding debt and/or equities in the hands of the public: AT&T Credit Holdings, Inc.; Teleport Communications Group, Inc; American Mobile Satellite Corporation; and Lanser Wireless, Inc.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page

Cases

Statutes

Legislative History

Administrative Materials

Nos. 99-3833 & 99-3908

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BRIEF FOR DEFENDANT-APPELLEE AT&T COMMUNICATIONS OF THE SOUTHWEST, INC.

STATEMENT OF ISSUES PRESENTED FOR REVIEW

1. Whether Southwestern Bell may assert a procedural due process claim where it does not allege that it was prejudiced by the denial of additional procedures, and does not identify any additional evidence or argument it would have presented if more elaborate procedures had been employed.

Codd v. Velger, 429 U.S. 624 (1977)
Estes v. Texas, 381 U.S. 532 (1965)
United States v. Torres-Sanchez, 68 F.3d 227 (8th Cir. 1995)

2. Whether the procedures employed by the Missouri Public Service Commission ("PSC") in this ratemaking arbitration were consistent with the requirements of the Due Process Clause.

United States v. Florida E. Coast Ry., 410 U.S. 224 (1973)
Louisiana Ass'n of Indep. Producers and Royalty Owners v. FERC, 958 F.2d 1101 (D.C. Cir. 1992)

3. Whether this proceeding is governed by the Missouri Administrative Procedures Act ("MAPA"), when a separate Missouri statute gives the PSC the authority to promulgate rules to govern proceedings before it.

§ 386.410(1), R.S. Mo.
State ex rel. Southwestern Bell Tel. Co. v. PSC, 645 S.W.2d 44 (Mo. App. W.D. 1982)
State ex rel. Southwestern Bell Tel. Co. v. PSC, 592 S.W.2d 184 (Mo. App. W.D. 1979)

4. Whether the arbitration proceedings contemplated by the Telecommunications Act of 1996 are "contested cases" within the meaning of the MAPA.

§ 536.010(2), R.S. Mo.
47 U.S.C. § 252(b)(4)
Cade v. Department of Social Servs., 990 S.W.2d 32 (Mo. App. W.D. 1999)

5. Whether Southwestern Bell's challenge to the PSC's forward-looking pricing methodology is an improper collateral attack on the Federal Communication Commission ("FCC") regulations mandating the use of such a methodology.

28 U.S.C. § 2342 (the Hobbs Act)
47 U.S.C. § 402(a)
Southwestern Bell Tel. Co. v. AT&T Communics., Inc., No. A-97-CA-132-SS, 1998 WL 657717 (W.D. Tex. Aug. 31, 1998)

6. Whether the PSC properly reduced Southwestern Bell's proposed nonrecurring charges (NRCs), where it found that Southwestern Bell's proposed rates were inflated and not adequately supported.

47 U.S.C. § 252(b)(4)(B)
GTE South, Inc. v. Morrison, 199 F.3d 733 (4th Cir. 1999)
Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, First Report and Order, 11 F.C.C. Rcd. 15499, ¶680 ("Local Competition Order")

7. Whether the PSC properly found that Southwestern Bell had voluntarily agreed to combine network elements for AT&T.

AT&T Corp. v. Iowa Utils. Bd., 119 S. Ct. 721 (1999)
US West Communics., Inc. v. MFS Intelenet, Inc., 193 F.3d 1112 (9th Cir. 1999)

STATEMENT OF THE CASE

A. The Act's Mandate Of Competition In Local Telephone Markets.

Local telephone service has historically been provided by regulated monopolies, in part because "[s]tate and federal regulators devoted their efforts over many decades to regulating the prices and practices of these monopolies and protecting them against competitive entry."[1] The Telecommunications Act of

[1] Implementation of Local Competition Provisions in the Telecommunications Act of 1996, First Report and Order, 11 F.C.C. Rcd. 15499, ¶ 1 (1996) ("Local Competition Order"), aff'd in relevant part, rev'd in part, Iowa Utils. Bd. v. FCC, 120 F.3d 753 (8th Cir. 1997), rev'd in part, aff'd in part, 119 S. Ct. 721 (1999).

1996, Pub. L. No. 104-104, 110 Stat. 56, was enacted to "end[] the longstanding regime of state-sanctioned monopolies." AT&T Corp. v. Iowa Utils. Bd., 119 S. Ct. 721, 726 (1999). To facilitate the transition to competition, Congress gave new entrants ("competitive local exchange carriers" or "CLECs") unprecedented rights of access to local telephone networks. It did so because even without the legal protections of monopoly, an incumbent local exchange carrier's ("ILEC's") established and ubiquitous network gave it a formidable advantage over new entrants. H.R. Rep. No. 104-204, at 74 (1995), reprinted in 1996 U.S.C.C.A.N. 10, 39-40; Local Competition Order ¶ 10. Through these landmark steps, Congress sought "to shift monopoly markets to competition as quickly as possible." H.R. Rep. No. 104-204, at 89, reprinted in 1996 U.S.C.C.A.N. at 55.

The local telephone network, owned by the local carrier, consists of a number of separate elements, beginning with "local loops." Loops are the cables strung on poles or buried underground that connect each subscriber to local or "central office" switches. These switches, which are essentially computers, route calls along the network to their destination. The switches are connected to each other through transport facilities ("trunks"). These transport facilities are integrated by various computer systems and databases that support network operations, the provision of services, connections to the facilities of other

telecommunications carriers, and the business side of offering telecommunications services (such as billing).

It was clear to Congress that no new entrant could effectively compete with an ILEC if it had to build its own loops, switches, trunks, databases, and computer systems from scratch. Iowa Utils. Bd. v. FCC, 120 F.3d 753, 816 (8th Cir. 1997), aff'd in part, rev'd in part, 119 S. Ct. 721 (1991); H.R. Conf. Rep. No. 104-458, at 148 (1996), reprinted in 1996 U.S.C.C.A.N. at 160. Congress recognized that incumbents would have both the ability and the incentive "to discourage entry and robust competition by not interconnecting its network with the new entrant's network or by insisting on supracompetitive prices or other unreasonable conditions for terminating calls from the entrant's customers to the incumbent LEC's subscribers." Local Competition Order ¶ 10.

For this reason, Congress prescribed a series of duties in § 251(c) of the Act "intended to facilitate market entry":

> Under this provision, a requesting carrier can obtain access to an incumbent's network in three ways: It can purchase local telephone services at wholesale rates for resale to end users; it can lease elements of the incumbent's network "on an unbundled basis"; and it can interconnect its own facilities with the incumbent's network.

AT&T Corp., 119 S.Ct. at 726 (citation omitted).

B. Implementation Of The Act.

1. FCC Regulations.

The Act directed the FCC to "establish regulations to implement the requirements of this section" within six months of its passage. 47 U.S.C. § 251(d)(1). The FCC issued its Local Competition Order on August 8, 1996.

Southwestern Bell and other ILECs, as well as a number of state utility commissions, challenged the FCC's order in a consolidated appeal in this Court. Although the Court "decline[d] [the ILEC's] request to vacate the * * * entire [Local Competition Order]," on July 18, 1997, the Court vacated the FCC's pricing rules on jurisdictional grounds and struck down a handful of other regulations. Iowa Utils. Bd., 120 F.3d at 819 & n.39. The Supreme Court reversed in substantial part, concluding that the FCC did have jurisdiction to issue its pricing regulations. See AT&T Corp. v. Iowa Utils. Bd., 119 S.Ct. at 733. The net effect of the Supreme Court's decision was to reinstate nearly all of the FCC's nationally uniform, pro-competitive rules implementing the Act.

2. Procedures for Establishing "Interconnection Agreements."

Congress established expedited procedures in section 252 to implement the Act's requirements. Incumbents must "negotiate in good faith" with requesting carriers seeking interconnection to arrive at interconnection agreements. 47

U.S.C. § 251(c)(1). "[I]f private negotiation fails, either party can petition the state commission that regulates local phone service to arbitrate open issues, which arbitration is subject to § 251 and the FCC regulations promulgated thereunder." AT&T Corp., 119 S. Ct. at 727; see 47 U.S.C. § 252(b)(1). Arbitrations are governed by section 252(b). In reviewing an arbitrated agreement, the state commission must ensure that it meets the requirements of section 251, including the FCC's implementing regulations, and the standards in section 252(d). See 47 U.S.C. § 252(e)(2)(B). Once an agreement is approved, any aggrieved party can "bring an action in an appropriate Federal district court to determine whether the agreement or statement meets the requirements" of sections 251 and 252. Id. § 252(e)(6).

STATEMENT OF FACTS

A. The First Arbitration

In March 1996, AT&T and Southwestern Bell commenced negotiations for a Missouri interconnection agreement. On July 29, 1996, AT&T petitioned the PSC for compulsory arbitration of unresolved issues. The PSC conducted hearings in October 1996, and issued its Arbitration Order on December 11, 1996. JA 431. The December 11 Order, however, only set interim rates. Id. at 481.

In an Order dated January 22, 1997, the PSC established the schedule for the development of permanent rates. JA 494-95. The PSC specifically noted that the first arbitration had been conducted under the time constraints imposed by the Act, "which did not permit the detailed analysis the Commission considers necessary for establishing permanent rates for unbundled elements and resale." JA 494. To develop permanent rates, the PSC ordered its Staff to meet with Southwestern Bell personnel 2-3 days each week in Southwestern Bell's offices "where software, data and subject matter experts responsible for critical input values will be readily available." JA 495. Because Southwestern Bell would be disclosing "extraordinarily confidential information, including trade secret and other proprietary matter" AT&T was not allowed to participate in those meetings. Id. Staff was also directed to meet with AT&T to identify critical inputs and to analyze costing models which AT&T endorsed. Id. Southwestern Bell was not allowed to participate in those meetings. The PSC designed this process to "allow the parties the opportunity to work with the Commission's advisory Staff to explain in a thorough, detailed and analytical fashion their costing models and final costing inputs." Id.

After months of meetings with the parties' subject matter experts, Staff compiled a Costing and Pricing Report which was several hundred pages long. JA 535. On July 31, 1997, two weeks *after* this Court in Iowa Utilities Board

had set aside much of the FCC's Local Competition Order, the PSC issued its Final Arbitration Order. The PSC's Order set permanent prices in accordance with Staff's Costing and Pricing Report. JA 517. The PSC noted that the Costing and Pricing Report constituted a "thorough and exhaustive review of each and every cost factor which the Commission finds relevant to this arbitration." JA 520. A 189-page redacted version of the Report was attached to the Order itself, JA 535; "[a] similar document containing highly confidential information [was] filed and provided to the parties pursuant to the Commission's procedures set out in its Protective Order." JA 520.

The PSC also recognized that because it had not issued proposed prices prior to issuing a final order, "in the interests of due process, the Commission will allow the parties twenty days to move for reconsideration or clarification," during which period the Order would not go into effect. JA 519, 522. Southwestern Bell indeed moved for clarification on August 20, 1997. JA 733. On October 2, 1997, the PSC granted Southwestern Bell's Motion for Reconsideration in part. JA 835.

The parties submitted their signed interconnection agreement to the PSC on October 10, 1997. JA 907. Three weeks later, Southwestern Bell filed a "Notice of Clarification," in which it claimed for the first time that, under this Court's July 18, 1997 Iowa Utilities Board decision, and contrary to the agreement it had

signed, "the CLEC (not SWBT) is required to physically combine the ordered [unbundled elements]." JA 1000.

B. The Second Arbitration

Because a number of issues remained unresolved, AT&T filed its petition for a second compulsory arbitration on September 10, 1997. AT&T and Southwestern Bell filed a joint list of remaining issues on October 24, 1997. JA 959. On October 30, 1997, the PSC issued an Order adopting a Procedural Schedule for the Second Arbitration. JA 989. The Order specified that no hearing would be held in the case, and that the PSC would base its arbitration order on the filed pleadings, as well as on any technical expertise provided by PSC Staff. JA 995.

The parties prefiled direct testimony on November 7, 1997. Southwestern Bell and AT&T met during the period of November 10 through 20 with the Arbitration Advisory Staff and with PSC General Counsel Dana K. Joyce, appointed by the Commission as a Special Master, for the purpose of resolving as many of the unresolved issues as possible. On November 21, the parties filed a Joint Settlement Document identifying the issues which had either been withdrawn or resolved by agreement. JA 1011. Also on November 21, the parties and the Special Master filed their Joint Statement of Remaining Issues, JA

1125, which was replaced by an amended statement on November 26. JA 1225. The Amended Statement identified each of the unresolved issues from the Joint Issues List and, for each issue, set forth (1) each party's proposed contract language, (2) the Special Master's recommendations, and (3) an explanation of the Special Master's recommendations. Southwestern Bell and AT&T each filed their responses to the Special Master's recommendations on November 26. JA 1311, 1339. The PSC issued its Report and Order on December 23, 1997. JA 1369.

C. Proceedings in the District Court.

Both AT&T and Southwestern Bell filed Complaints in the District Court seeking review of various provisions of the Interconnection Agreement approved by the PSC. The cases were consolidated. After briefing and oral argument, the District Court issued a 70-page Order Affirming in Part and Remanding in Part on August 31, 1999. JA 1691.

The District Court rejected Southwestern Bell's due process claim primarily on the ground that, "[a]s SWBT's counsel admitted in oral argument, SWBT has made no specific allegation that it was prejudiced by the PSC's failure to follow its recommended procedures." JA 1725. The Court rejected Southwestern Bell's argument that *ex parte* contacts tainted the PSC's decision,

since, by publishing the Staff Report on which it had exclusively relied, "the PSC [ ] shared all relevant facts with SWBT, and allowed it to move for reconsideration." JA 1727. The Court also rejected Southwestern Bell's argument that cross-examination was necessary, since "[t]echnical cases like this one typically turn on inferences to be made from fact, rather than upon the credibility of witnesses. Such inferences are best supported by argument, rather than live testimony." JA 1729.

The Court likewise found that no additional procedures were required by Missouri law: "[b]ecause the PSC's arbitration was a *sui generis* proceeding, no state procedural law was controlling." JA 1734.

Finally, the Court also rejected the substantive arguments Southwestern Bell presses here. It held that the FCC's pricing rules, which had been reinstated by the Supreme Court, "are binding in this proceeding," and required affirmance of the PSC's use of a forward-looking pricing methodology. JA 1715. The Court also held that "the PSC [properly] based its decision to reduce SWBT's [nonrecurring costs ('NRCs')] on flaws in the data from which SWBT compiled its estimate of its NRCs." JA 1717. The Court found that Southwestern Bell "failed to make a contemporaneous objection" to provisions of the interconnection agreement requiring it to combine network elements for AT&T,

and that the PSC was accordingly justified in finding "that SWBT voluntarily agreed to combine network elements." JA 1738.

SUMMARY OF THE ARGUMENT

After an expedited process lasting over a year, the Missouri Public Service Commission (the "PSC") approved an Interconnection Agreement between AT&T and Southwestern Bell, specifying the terms for AT&T's entry into the Missouri local telephone market. In this appeal, Southwestern Bell makes only limited claims that the Interconnection Agreement violates the Act (apart from its continuing challenge to the forward-looking pricing methodology endorsed by the FCC and applied by the PSC). Rather, Southwestern Bell seeks to overturn the results of the PSC proceedings based largely on its claim that the Due Process Clause, and Missouri's Administrative Procedures Act ("MAPA"), required the PSC to conduct the expedited proceedings required by the Act as a full-blown civil trial.

Southwestern Bell's due process claim ignores the well-established law that a party claiming it was denied due process must show that it was prejudiced. Southwestern Bell admitted to the District Court that it had not made this showing. On appeal, Southwestern Bell does no more, other than intoning that the PSC's procedures were not fair, and that the PSC's substantive decisions are

wrong. Southwestern Bell identifies no additional evidence, nor argument, it would have presented if more elaborate procedures had been employed. Standing alone, Southwestern Bell's failure to show prejudice justifies denial of its procedural due process claim.

But even if Southwestern Bell's constitutional claim were properly presented, it would not mandate reversal. Southwestern Bell's claim that trial-type procedures were constitutionally required here ignores the long-standing principle that prospective rate-making proceedings like the PSC's arbitration are more closely akin to legislative or rulemaking proceedings than to adjudications of historical facts, and that far lesser procedural formality is required in this context. Even if the Court were to apply caselaw concerning adjudications, no further procedures are warranted under the three-part test of Mathews v. Eldredge, 424 U.S. 319 (1976): Southwestern Bell's desire to charge its competitors higher rates is not the sort of interest to which heightened protections attach; the risk of error in the resolution of the highly technical issues involved here does not mandate a trial; and the public interest in expediting the (long-overdue) transition to competition in the local telephone market weighs against unnecessary procedural formality.

Missouri law requires nothing more. First, the MAPA cannot apply here, as a matter of federal law, because it would be inconsistent with congressional

intent to resolve interconnection-agreement arbitrations expeditiously, subject to judicial review in federal, not state, courts. Further, as a matter of Missouri law the MAPA does not apply to proceedings in which the PSC has established different procedures; even if the MAPA did apply, the "arbitration" contemplated by the Act is not a "contested case" within the meaning of the MAPA.

Southwestern Bell's substantive arguments fare no better. First, Southwestern Bell's general challenge to the forward-looking pricing methodology applied by the PSC (and mandated by binding FCC rules) is not properly presented here, since it is a collateral attack on FCC rules which may only be challenged directly in the Courts of Appeals. Second, the PSC based its reduction of Southwestern Bell's NRCs on a careful review of the data Southwestern Bell submitted, and the reasonable determination that Southwestern Bell's proposed NRCs were substantially overstated. Finally, the PSC did not err in finding that Southwestern Bell had entered a binding, voluntary agreement to combine network elements for AT&T, since Southwestern Bell eschewed several opportunities to contest its obligation to combine elements for AT&T, and signed an agreement assuming this obligation even after this Court held that the Act did not require it.

STANDARD OF REVIEW

The 1996 Act does not specify the standard of review applicable to the PSC's determinations. The vast majority of courts, however, including two federal courts of appeal, have held that a state commission's interpretations of federal law are reviewed *de novo*, and all other determinations are reviewed under the "arbitrary and capricious" standard. See, e.g., GTE South, Inc. v. Morrison, 199 F.3d 733, 745 & n.5 (4th Cir. 1999); US WEST Communics. v. MFS Intelenet, Inc., 193 F.3d 1112, 1117 (9th Cir. 1999); AT&T Communics., Inc. v. Contel, Inc., No. 97-901, slip op. at 10-14 (D. Minn. Apr. 30, 1998); US West v. Thoms, Civ. No. 4-97-CV-70082, slip. op. at 10-11 (S.D. Iowa Jan. 24, 1999); US WEST Communics., Inc. v. Hix, 986 F. Supp. 13, 19 (D. Colo. 1997).

Here, the *de novo* standard of review applies to Southwestern Bell's "due process" claim, to the extent it relies on federal law, and would apply to Southwestern Bell's claim that the 1996 Act requires the PSC to establish network element rates based on Southwestern Bell's embedded costs, if that claim were properly raised here. Southwestern Bell's remaining claims are subject to arbitrary and capricious review. Specifically, that standard applies to: (i) the PSC's factual determination that Southwestern Bell voluntarily agreed to provide AT&T with network elements in combination, and thus waived its right to contest

that contractual obligation, see, e.g., NLRB v. Wizard Method, Inc., 897 F.2d 1233, 1236 (2d Cir. 1990) (enforcing NLRB order finding that private party waived argument contrary to existing NLRB precedent by failing to object before ALJ); and (ii) the PSC's factual determination that Southwestern Bell's proposed nonrecurring charges ("NRCs") were improperly inflated and inadequately supported, and thus had to be substantially reduced. See, e.g., Arkansas Medical Soc'y v. Reynolds, 6 F.3d 519, 529 (8th Cir. 1993) (applying arbitrary and capricious standard to review of state agency's ratemaking decisions under federal statute).

In addition, the PSC's interpretation of the state laws it administers "is entitled to great weight." Linton v. Missouri Veterinary Med. Bd., 988 S.W.2d 513, 517 (Mo. 1999) (quoting Foremost-McKesson, Inc. v. Davis, 488 S.W.2d 193, 197 (Mo. banc 1972)). "'Deference to the agency action is even more clearly in order when interpretation of its own regulations is at issue.'" Morton v. Missouri Air Conserv. Comm'n, 944 S.W.2d 231, 238 (Mo. App. S.D. 1997) (citation omitted).

ARGUMENT

I. The District Court Properly Rejected Southwestern Bell's Procedural Arguments.

Apparently unconvinced of the merits of its substantive claims, Southwestern Bell devotes the bulk of its brief to a challenge to the procedures by which the PSC reached its decision. Southwestern Bell argues that the Due Process Clause requires state commissions to employ full-blown, trial-type procedures in prescribing rates under the Act, see SWB Br. 27-47, or that, in the alternative, such procedures were mandated by Missouri law. Id. at 48-54. As shown in part A below, Southwestern Bell's constitutional argument falls flat because it cannot satisfy the settled rule that procedural due process claimants must show that they were prejudiced by the absence of additional procedures. In any event, as shown in part B, Southwestern Bell's sweeping constitutional claim rests on a fundamental misunderstanding of the requirements of due process. Finally, part C shows that Missouri law did not require more elaborate procedures than the PSC employed here.

There is an air of unreality in Southwestern Bell's claim that it was denied notice and an opportunity to be heard on the cost and rate issues resolved by the PSC. AT&T's position in the proceedings could hardly have come as a surprise to Southwestern Bell because AT&T and Southwestern Bell have squared off in

literally dozens of proceedings, both before the FCC and various state commissions across Southwestern Bell's service region. In each such proceeding, both the issues and the parties' positions have been essentially the same. In the end, the best evidence that Southwestern Bell's "due process" challenge is simply the latest in a series of attempts to derail efforts to open its monopoly business to competition is Southwestern Bell's failure to identify *any* link between its limited claims on the merits and the alleged procedural infirmities upon which it asks the Court to undo the years-long process that led to this appeal.

A. Southwestern Bell's Erroneous Due Process Claim Need not Be Addressed because Southwestern Bell Has Failed To Make the Required Showing of Prejudice.

The district court properly identified the glaring flaw in Southwestern Bell's procedural due process argument: Southwestern Bell has failed to show that it suffered any prejudice from the PSC's failure to afford it trial-type process.

1. The law on this point is clear. "In this circuit, the establishment of a fundamentally unfair hearing in violation of due process requires a showing both of a fundamental procedural error and that the error caused prejudice; *an error cannot render a proceeding fundamentally unfair unless that error resulted in*